UNITED STATES BANKRUPTCY COURT

DISTRICT OF HAWAII

In re	)	Case No. 97-03746
	)	Chapter 11
UPLAND PARTNERS,	)	
	)	Re: Docket Nos. 2436, 2475
Debtor.	)	2492, 2705
_____	)	

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND INTERIM ORDER REGARDING SECOND APPLICATION FOR INTERIM COMPENSATION BY TRUSTEE'S COUNSEL

Introduction

On April 23, 2003, the Trustee's counsel filed the Trustee's Second Interim Application for Allowance and Award of Professional Fees and Reimbursable Expenses (the "Second Fee Application"). The court held a hearing on the Second Fee Application and, on June 19, 2003, the court entered its Order Granting the Trustee's Second Interim Application for Allowance and Award of Professional Fees and Reimbursable Expenses ("Second Fee Order"). The order allowed fees and expenses totaling $102,921.79 to the Trustee's counsel and authorized payment of $72,738.99 as a surcharge, pursuant to 11 U.S.C. § 506(c), against proceeds subject to liens claimed by Kula-Olinda Associates ("KOA"). On July 1, 2003, the court entered an order denying a motion to vacate filed by William S. Ellis, Jr. Mr. Ellis appealed both orders to the District Court.

On December 15, 2003, the District Court entered its Order Vacating and Remanding Bankruptcy Judge's Orders Dated June 19, 2003, and July 1, 2003 ("Remand Order"). The District Court ruled that this court failed to state its findings and reasoning on the record and, therefore, the District Court could not properly review the decision. The District Court expressed particular concern about the surcharge of fees in the category of "Fee Applications" and whether the Second Fee Order awarded duplicate fees and expenses for the period from August 15 to August 31, 2002. The District Court, therefore, vacated the orders and remanded the case to this court "to make appropriate findings of fact and conclusions of law or at least set forth his reasoning."

The District Court noted that, "As the Bankruptcy Judge has already received full briefing on the request and conducted a hearing, the Bankruptcy Judge may, in his discretion, simply issue an amended order. Alternatively, the Bankruptcy Judge may, in his discretion, request further briefing or hold another hearing on the matter." With one exception (discussed below), neither further briefing nor further argument is necessary.

Findings of Fact

Based on the entire record of this case, I find as follows:

1. When the bankruptcy case began, the estate consisted primarily of approximately fifty acres of land in upcountry Maui. The property is called the "Kulamanu project." Many factors make the Kulamanu project difficult to develop. Much of the land is steeply sloped, which makes it difficult to create lots with adequate buildable area. Zoning and setback changes may have further reduced the potential number of lots. Upcountry Maui has suffered a chronic water shortage. Obtaining water from the public water system is difficult and at some times has been impossible.

2. Debtor Upland Partners ("Upland") and predecessor entities largely controlled by Mr. Ellis owned the Kulamanu project since about 1960.

3. From 1960 to 2002, only modest progress was made toward developing the Kulamanu project. A portion of the project was subdivided into eleven lots, the requisite subdivision improvements were built, and the County of Maui issued final subdivision approval for those lots. Prior to March 2002, however, only four of the eleven lots were sold. The county granted preliminary approval to subdivide the remaining land into fifty-seven lots, but the continuing viability of that proposal was questionable because the county had reduced the minimum lot size and increased the minimum setbacks. Both of these changes would have reduced the developable area and value of the project. No progress

had been made toward actually building the subdivision improvements on the remaining land.

4. Although the Kulamanu project faced physical and regulatory challenges, the biggest impediment to the project was the conduct of its principals, including Mr. Ellis. After an eight day trial in Adv. No. 99-0081 (an adversary proceeding brought by Mr. Ellis to challenge the claims of a secured creditor), the court found that:

> 8. In the context of this litigation, the Kulamanu Project, and the related agreements, Ellis, Upland, and KOA have never had the financial or the organizational ability to accomplish anything, without the assistance of others.
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> 9. For Ellis, Upland, and KOA, non-performance of obligations, litigation, bankruptcies, and the use of an array of Ellis-related entities have been the regular course of behavior.
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> 10. The conduct of Ellis has greatly complicated both this adversary proceeding and the underlying bankruptcy case, in which Upland is the debtor-in-possession. As an example, on May 4, 2000, during the course of this trial, Ellis assigned or attempted to assign the claims of KOA to a third party. . . . This was done without notice to KOA's trial counsel, who appears to have worked closely with Ellis for many years. . . .
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> 11. In the Upland chapter 11 case which is currently pending, Ellis filed claims 18, 19, 20, and 21. During the course of hearings on objections to those claims, it was discovered that Ellis had altered

> promissory notes attached to the proofs of claim by removing language of rescission. . . .
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> 12. Ellis is a litigious person. According to his own testimony, lenders are reluctant to finance projects in which he has a role, because of his tenacity in resisting mortgage foreclosures.
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> 13. Ellis has had three personal bankruptcies in this district. The last one, Case No. 72-391, was open for more than 20 years. The Kulamanu Project, which is involved in this adversary proceeding and is part of the bankruptcy estate of Upland, was part of that Ellis bankruptcy case.
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> 14. Ellis has been a party to decades of failed efforts to develop the Kulamanu Project into residential subdivisions.

Mr. Ellis did not appeal from the judgment based on these findings.

5. The Upland case exemplifies Mr. Ellis' habitual litigation conduct and the dangers that confront anyone considering an acquisition of the Kulamanu project. As of February 9, 2004, 2,750 documents had been filed and docketed in this bankruptcy case. Only three cases commenced in the bankruptcy court for this district since 1991, when the court implemented a computerized docketing system, have had more docket entries. The debtors in those cases were Liberty House, Inc. (3,510 filings), the owner of a chain of department stores, Hamakua Sugar Company, Ltd. (3,490 filings), the owner of a large sugar plantation on the Big Island, and Sukamto Sia (2,862 filings to date), an Asian

financier with holdings spread across the globe. As another point of comparison, the first chapter 11 case of Hawaiian Airlines, Inc.,[1] a regional air carrier and a public company, had 2,130 filings, 620 fewer than this case to date (and this case is not yet closed). Mr. Ellis has contributed more than his share of the filings in this case, and he has forced the other parties to make unnecessary filings and incur needless expense. For example, since January 1, 2000, Mr. Ellis has withdrawn at least sixteen pleadings which he filed. In most cases, he did so after other parties had incurred the expense and burden of filing responses. In this and many other ways, Mr. Ellis has unreasonably multiplied this litigation for no proper purpose.

6. Mr. Ellis' conduct in this case is consistent with a larger pattern. That pattern is a matter of public record. Mr. Ellis has a long track record as an obstructive litigant. Mr. Ellis has been an active pro se litigant in Hawaii's state and federal courts for decades. The earliest published decision in which he appears is James v. Kula Development Corp., 49 Haw. 508, 421 P.2d 296 (1966). Many courts have commented adversely on his conduct in and out of court. See, e.g., In re Corey (Corey v. Loui), 892 F.2d 829 (9th Cir. 1989); Ellis v. Cassidy, 625 F.2d 227, 230 (9th Cir. 1980) (affirming the district court's decision that Mr. Ellis had "brought suit 'in bad faith and vexatiously'" and that his claims "were

[1] Hawaiian Airlines, Inc., is now the debtor in a second Chapter 11 case.

'frivolous' or 'meritless'"); Sumida v. Yumen, 444 F.2d 1281, 1282 (9th Cir. 1971) ("[T]here seems to be no end to the multitudinous applications, briefs and maneuverings of the appellants through counsel and William S. Ellis, Jr., appearing in pro. per."); Ellis v. J-R-M Corp., 324 F.Supp. 768, 773, 780 (D. Haw. 1971)(where the court stated that "This retroactive shifting of dates is typical of the various documents and manoeuvers engineered by Ellis throughout . . ." and found that Ellis' conduct "amount[ed] to a fraud on the court . . . ."); MDG Supply, Inc., v. Diversified Investments, Inc., 51 Haw. 375, 375-76, 463 P.2d 525, 526 (1969) ("Originally, Kula Development Corporation and William S. Ellis, Jr., had also joined as appellants. But they have withdrawn after considerably muddying the record."); Harada v. Ellis, 4 Haw. App. 439, 444, 667 P.2d 834, 838 (Haw. App. 1983) (stating, in reference to the conduct of Mr. Ellis and his co-defendants, "We abhor such deplorable tactics. We will not tolerate them, and we encourage trial courts not to tolerate them," and finding that the defendant's appeal was frivolous); Ellis v. Harland Bartholomew and Assoc., 1 Haw. App. 420, 428, 620 P.2d 744, 749 (Haw. App. 1980) ("Th[e] record is replete with delay, maneuvering, contrivance and artful dodging of diligent prosecution. . . . We agree with the defendants-appellees' assessment that [Mr. Ellis] has 'impended the progress of

this litigation by every obstacle and maneuver which (his) ingenuity could command.'")

7. This public record of Mr. Ellis' misconduct reduces the value and marketability of the Kulamanu project. Anyone who does business with Mr. Ellis or an entity in which he has an interest must assume the risk of protracted and costly litigation over meritless claims. As a consequence, any prudent person who buys property with which Mr. Ellis is involved will pay less than he or she would otherwise pay.

8. When Richard Emery became successor trustee and Lyle Hosoda became his counsel in March 2002, the court had already lifted the automatic stay to permit Quadrant Holdings Pty. Ltd. ("Quadrant") and Kula-Olinda Associates ("KOA")[2] to foreclose their respective mortgages. Quadrant had filed a motion for summary judgment seeking a decree of foreclosure as to the seven subdivided lots. KOA was simultaneously seeking to foreclose its mortgage. The parties do not dispute that a foreclosure sale would have occurred if the Trustee had not found a buyer.

[2]Mr. Ellis is the president of Olinda Land Corp., the sole general partner of KOA. Mr. Ellis apparently controlled KOA until the court authorized certain of its limited partners to act on behalf of KOA.

9. For the reasons explained in detail in the Findings of Fact and Conclusions of Law Regarding Payment of Fees and Expenses to Trustee and His Counsel Under 11 U.S.C. § 506(c), filed on February 11, 2003, KOA could not have successfully bid for the property at a foreclosure sale of the estate's real property, and such sales would have yielded not more than $171,000 for payment to KOA after payment of the costs of sale and senior liens.

10. Shortly after his appointment, the Trustee negotiated a contract to sell the remaining property of the estate to KRS Development, Inc. ("KRS") for $2,200,000.00 in cash. The price offered by KRS was fair, reasonable, and the best achievable under the circumstances (see Findings of Fact and Conclusions of Law Regarding Proposed Sale of Certain Property, filed on June 27, 2002). The sale was approved by order entered on June 27, 2002. The sale closed on August 15, 2002. The closing costs, real property taxes, and Quadrant's first mortgage of $776,940.33 were paid in full. The estate realized net proceeds of $1,285,587.13 that were held pending resolution of the disputes concerning KOA's alleged secured claim.

11. The work of the trustee and his counsel to sell the property to KRS conferred upon KOA a direct, non-hypothetical, quantifiable, and quantified benefit worth at least $1,114,587.13 (the difference between the net proceeds of the

KRS sale of $1,285,587.13 and the maximum net proceeds from a foreclosure sale of $171,000).

12. The conduct of KOA and Mr. Ellis has substantially increased the work required of, and therefore the fees incurred by, the trustee and his counsel. KOA and Mr. Ellis have taken positions that are not only obstinate and contrary to the interests of the estate, but also contrary to the interests of KOA itself. A reasonable, economically rational creditor in KOA's position would have cooperated with the sale to KRS. The limited partners of KOA with a 71.13 percent interest in the partnership supported the sale to KRS.

13. The trustee and his counsel have persisted in moving this case toward closure under exceptionally difficult circumstances. The time spent by the trustee's counsel was reasonable and necessary. The rates charged are reasonable and in line with the applicable market rate in this community for comparable services. All services for which the trustee's counsel seeks compensation were necessary to the administration of the estate, beneficial to the estate, and not unnecessarily duplicative. The services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problems, issues, and tasks addressed. The compensation requested is reasonable

based upon the customary compensation charged by comparably skilled practitioners in non-bankruptcy cases.

14. The services provided by the Trustee's counsel in the categories (as set forth in the Second Fee Application) of "Appeals," "Asset Disposition," "Injunctive Relief," and "State Foreclosure Action" constitute reasonable, necessary expenses of disposing of property in which KOA claims an interest, and were beneficial to KOA.

15. When the Second Fee Order was entered, KOA's alleged secured claim encumbered all of the estate's assets. The Trustee filed an adversary proceeding (Adv. Pro. No. 02-00043) to challenge KOA's claims and alleged liens. The court permitted certain limited partners of KOA to intervene in that adversary proceeding. On October 14, 2003, the court entered orders that determined (in summary) that the intervening limited partners are entitled to act on behalf of KOA and approved a settlement between the Trustee and KOA pursuant to which KOA's secured claim was reduced to $400,000. This leaves more than enough money in the estate to pay the amounts requested in the Second Fee Application in full without surcharging KOA's collateral.

16. The District Court's Remand Order questioned whether duplicate fees and expenses for the period from August 15 to August 31, 2002,

were awarded in the Second Fee Order. The District Court pointed out that the order granting interim compensation entered on February 11, 2003 ("First Fee Order") covered the period up to August 31, 2002, but the Second Fee Order covered the period beginning on August 15, 2002. The District Court was understandably misled by a typographical error in the First Fee Order. The first interim fee application for Trustee's counsel filed on August 22, 2002, was for the period from March 12 to August 15, 2002. The First Fee Order, however, incorrectly states that it allows compensation for the period through August 31, 2002. The Second Fee Application covers the subsequent period from August 15 to December 31, 2002. There is no overlap in the periods for which the Trustee's counsel seeks fees and expenses.

17. The Second Fee Application may, however, duplicate the First Fee Order in another way. The billing records attached to the Second Fee Application include fees for services rendered prior to August 15, 2003, which seem to be identical to services and fees approved in the First Fee Order (see, for example, the project categories of "Injunctive Relief" and "Claims Administration and Objections").

Conclusions of Law

Based upon these findings of fact, I make the following conclusions of law:

1. With the possible exception of the fees that may duplicate the amounts awarded in the First Fee Order, the amounts requested by the trustee and his counsel in their original applications represent reasonable compensation for actual, necessary services and reimbursement for actual, necessary expenses, within the meaning of section 330(a).

2. Because KOA's secured claim has been settled and there are more than enough funds to pay in full the amounts requested in the Second Fee Application without surcharging KOA's collateral, I need not decide whether and to what extent those amounts may be surcharged against KOA's collateral under section 506(c). Mr. Ellis, however, has appealed the order approving the settlement. Out of an abundance of caution, I will address the section 506(c) issue.

3. Mr. Ellis lacks standing to object to the surcharge. Mr. Ellis has no secured claims. (When the Second Fee Application first came before me, Mr. Ellis contended that KOA had assigned its secured claims to him. Mr. Ellis later caused KOA to "rescind" the assignment.)

4. Even if Mr. Ellis had standing, his objections have no merit.

5. In most instances, the proceeds of property which is subject to a lien are distributed first to the holder of the secured claim. Administrative expenses, such as the fees and expenses of the trustee and the trustee's attorneys, are usually paid only after the secured claims are paid. "Administrative expenses or the general costs of reorganization may not generally be charged against secured collateral." In re Cascade Hydraulics & Utility Service, Inc., 815 F.2d 546, 548 (9th Cir. 1987).

6. Section 506(c) creates a limited exception to this general rule. Section 506(c) permits a trustee to "recover from property securing an allowed secured claim the reasonable, necessary costs and expense of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim." This section creates a three-pronged test. The trustee is entitled to a surcharge under section 506(c) only if the trustee shows that the expenses in question were (1) reasonable, (2) necessary, and (3) beneficial to the secured creditor. Cascade Hydraulics, 815 F.2d at 548.

7. "The most important element as well as the most difficult to prove is that the secured creditor received a benefit." In re Evanston Beauty Supply, Inc., 136 B.R. 171, 176 (N.D. Ill. 1992). The Court of Appeals for the

Ninth Circuit has emphasized that "[t]his is not an easy standard to meet" and that "a party seeking a surcharge faces an onerous burden of proof . . . ." In re Debbie Reynolds Hotel & Casino, Inc., 255 F.3d 1061, 1068 (9th Cir. 2001). Expenses are recoverable only "when incurred primarily for the benefit of the secured creditor or when the secured creditor caused or consented to the expense." Cascade Hydraulics, 815 F.2d at 548. The trustee need not show that the trustee had "the best interest of the secured creditors in mind," In re Palomar Truck Corp., 951 F. 2d 229, 232 (9th Cir. 1991). "Rather, the focus is on whether the expenditure in question was directed specifically toward the collateral, as opposed to property of the estate generally." In re Choo, 273 B.R. 608, 611 (B.A.P. 9th Cir. 2002) The benefit must be established "in quantifiable terms," the benefit must not be "hypothetical," and the trustee's recovery is limited to the amount of the secured creditor's benefit. Cascade Hydraulics, 815 F.2d at 548. Further, indirect benefits to the secured creditor are insufficient. In re Glasply Marine Indus., Inc., 971 F.2d 391, 394 (9th Cir. 1992).

8. A surcharge is also appropriate where the creditor caused or consented to the expenses at issue. In egregious circumstances, a secured creditor's obstinacy and unreasonable failure to cooperate can "cause" expenses that can in turn be surcharged against the creditor under section 506(c). In re

Iberica Mfg., Inc., 180 B.R. 707, 713 (Bankr. D.P.R. 1995)(The secured creditor's "conduct caused the expenses to be incurred . . .[and] has undoubtedly delayed disposition of the debtor's property to the detriment of its own claim").

9. The services and expenses in the categories of "Appeals," "Asset Disposition," "Injunctive Relief," and "State Foreclosure Action" (as set forth in the Second Fee Application) were reasonable and necessary costs and expenses of disposing of the property that was subject to the alleged KOA mortgages. Those services conferred direct, non-hypothetical, quantifiable benefits upon KOA, worth at least $1,114,587.13. (The services in the remaining categories are not a proper surcharge under section 506(c).) A ratable share of the reimbursement of costs should also be included in the surcharge.

10. The property which KOA claims as collateral was the primary beneficiary of the efforts of the trustee and his counsel. All of the services in the foregoing categories were directed toward selling the property at the best possible price given the prevailing circumstances and clearing the obstacles to a court approved sale, including many obstacles which KOA and Mr. Ellis unreasonably created.

11. The benefits of the sale to KRS are not speculative. The record establishes, to a high degree of certainty, that if the trustee had not engineered the

sale to KRS, there would have been a foreclosure sale, and that a foreclosure sale would have been disastrous for KOA.

12. The unreasonable – and, indeed, economically irrational and self-defeating – conduct of KOA and Mr. Ellis caused most, if not all, of the compensation and reimbursement for which the trustee and his counsel seek a surcharge.

Order

The Trustee's counsel must carefully review his Second Fee Application in its entirety to determine if any of the fees or expenses requested duplicate the fees or expenses that were previously awarded in the First Fee Order. Not later than February 23, 2004, Lyle S. Hosoda & Associates, LLC, counsel for Trustee Richard Emery, shall file either a statement explaining that there is no duplication of fees or a revised second fee application that eliminates any such duplication. Any party in interest may respond no later than March 8, 2004. The Trustee and Trustee's counsel may file a reply not later than March 15, 2004.

DATED: Honolulu, Hawaii, February 13, 2004.

/s/ Robert J. Faris
United States Bankruptcy Judge